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IN THE

SUPREME COURT

OF THE

UNITED STATES.

OCTOBER TERM, 1939.

Nos. 23 and 24.

In the Matter of
LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

Debtor.

THOMAS K. CASE and ADELE B. COWAN,

Petitioners,

vs.

LOS ANGELES LUMBER PRODUCTS COMPANY, LTD.,
a corporation,

Respondent.

RESPONDENT'S REPLY TO BRIEF OF THE UNITED STATES, AMICUS CURIAE.

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RESPONDENT'S REPLY TO BRIEF OF THE UNITED STATES, AMICUS CURIAE.

To the Honorable Charles Evans Hughes, Chief Justice, and to the Honorable Associate Justices of the Supreme Court of the United States:

STATEMENT OF CASE.

Reference is made to the statement of the case which appears at the opening of respondent's brief in opposition to petition for writ of certiorari.

Under the heading "The Plan of Reorganization" the government states that "in return for a claim for principal and interest $3,807,071, the bondholders will receive but 77% of the assets of the enterprise, represented by securities having a par value, asset value, and a liquidating preference of only $641,375. The remaining 23% will go to the Class A stockholders." This is inaccurate in that under the Plan the Class A stockholders, after a preference of $641,375 to the old bondholders, will then be entitled on liquidation to be paid $188,625 and thereafter the balance of any remaining assets to be liquidated will be distributed pro rata to old bondholders and old stockholders. [R. pp. 60-61.]

The statement of counsel for the government under the heading "Disposition of Plan in the Lower Courts" is not complete or accurate. The decisions of the District [R. pp. 202-245] and Circuit Court [R. pp. 372-380] in the record speak for themselves.

For the purpose of this argument, let us admit the government's statement that the courts have regarded the fairness and equity of a plan of reorganization as a question of law. The petitioners repeat at many points in their brief that they agreed by stipulation [R. p. 285] not to question and also that at no time have they questioned the findings of fact of the District Court. Petitioners do not question the sufficiency of the consideration given by the old shareholders for their right to participate in the Plan. Petitioners merely argue that the old shareholders

cannot participate to any extent whatever where the debtor is found to be insolvent. The government's attack on the fairness of the Plan in this case, however, is made by questioning one of the premises, *i. e.*, findings of fact upon which the District Court based its "conclusion" that the Plan was fair and equitable, to-wit: the sufficiency of the new consideration moving from the old shareholders as a basis for their participation in the Plan. The District Court made findings of fact [R. pp. 320-323] based upon the evidence submitted to it that (a) the Class A shareholders have had the management and control of the debtor and have this right to its management and control until 1944, (b) the bonds of debtor are owned by approximately 757 individuals who are widely scattered and unorganized and it will be beneficial to the bondholders to allow Class A shareholders to participate in this reorganization so as to provide continuity of management, (c) it will be an asset to the new company and its shareholders to retain debtor's Class A shareholders as shareholders of the new company because of their familiarity with the operation of the business of debtor and because of their financial standing and influence in the community, (d) by virtue of the 1930 reorganization payment of interest on the outstanding bonds was waived, unless earned, until 1944 and that for all practical purposes said bonds cannot be foreclosed until they mature in 1944, (e) the principal valuable consideration passing between the bondholders and the stockholders to justify participation of stockholders in the Plan is the virtual abrogation of said agreement deferring foreclosure until 1944, (f) the bondholders cannot now foreclose nor can they acquire the assets securing debtor's bonds without long and protracted litigation which would be expensive and of great

injury to debtor as a going concern, (g) bonding companies are unwilling to assume risk of becoming surety for debtor because of the outstanding bond issue, and that without surety bonds bids cannot be made on the building of new ships and operations are restricted to small repairs, (h) the United States Government is planning construction of many vessels, certain of which debtor is capable of building, and that by reason of said program valuable opportunities are open to debtor to build ships which will be lost to debtor, its bondholders and other interested parties, if litigation is commenced and if the Plan is not approved, (i) the value to the bondholders of maintaining debtor as a going concern and of avoiding litigation is in excess of the value of the stock being issued to the Class A stockholders under the Plan. [R. pp. 320-323.] There was a further valuable consideration flowing from the old shareholders out of the fact that the Class A stockholders were willing to reorganize and permit a cancellation of the trust indenture immediately. The trust indenture required the maintenance of certain northern properties of respondent at an estimated annual expense for said shut-down properties of $21,500. [R. pp. 67-68, 313.] This amount for approximately eight years would have amounted to $172,000 which would have had to be paid out of the assets of respondent were it not for the Plan which provided for an immediate elimination of the trust indenture and this annual expense. Instead of this continuing expense the Plan provides for an immediate liquidation of these northern properties and a

distribution of the proceeds thus realized to the bondholders alone. [R. p. 35.] This, we submit, was a further substantial contribution which the Class A shareholders by their consent and cooperation made possible under the Plan. These are the findings of fact of the District Court. Petitioners in the United States Circuit Court of Appeals were barred and are here barred by their stipulation [R. p. 285] from questioning findings of fact of the District Court. If this avenue of attack is closed to the petitioners, we submit, it is not open to the Government. Furthermore, the record on which the trial court made its findings of fact with respect to relative values is not before this court, the stipulation that findings of fact would not be questioned being substituted for such record.

Summary of Argument as Requested by Paragraph 2(f) of Rule 27.

Answer to Government's statement as to the interest of the United States.

Congress left the findings of fact upon which the fairness of plans of reorganization should be based to the United States District Courts, subject to review on appeal. The Government is urging the Supreme Court to legislate rules to guide the District Courts and other governmental agencies in their fact finding tasks. To grant the Government's demands would plunge the Supreme Court into the legislative field reserved to Congress.

The general public interest can best be served by a disposition by the Supreme Court, case by case, of questions presented in those cases.

I.

Answer to Government's Point I.

The Government's contention that "No PLAN OF REORGANIZATION WHICH FAILS TO GIVE PRECEDENCE TO THE ENTIRE CLAIM OF SENIOR CREDITORS BEFORE PARTICIPATION OF JUNIOR CREDITORS OR STOCKHOLDERS IS FAIR AND EQUITABLE AS A MATTER OF LAW," is not supported by reason or authority.

The standard of fairness controlling in the instant case does not do violence to the *Boyd* case. (*Northern Pac. Ry. Co. v. Boyd*, 228 U. S. 482 [1912].) In the instant case the old bondholders are given all of the assets which were covered by their mortgage plus what they could realize upon by a deficiency action, save and except the 20-plus per cent allocated under the Plan to the old shareholders in exchange for the new consideration contributed by the old shareholders.

II.

We do not take issue with the Government on its Point II that "A PLAN WHICH IS UNFAIR AS A MATTER OF LAW CANNOT BE MADE VALID BY THE CONSENT OF REQUIRED PERCENTAGE OF A CLASS OF SECURITY HOLDERS," but earnestly contend such proposition is not applicable in the instant case.

III.

Answer to Government's Point III.

The Government's contention that "THE ALLEGED 'CONSIDERATION' TO BE FURNISHED BY THE STOCKHOLDERS DOES NOT SUPPORT THEIR PARTICIPATION UNDER THE PLAN" is not tenable.

The petitioners have never raised this question either in their specifications of error or in their brief; therefore the

Government should not be permitted to urge this point. Nevertheless the answer is: the District Court found as a matter of fact that the "consideration" was adequate and the petitioners agreed by written stipulation not to question the findings of fact of the trial court and have not questioned this finding. The evidence upon which the District Court's finding was based is not before this Court because of said stipulation. This Court, in the absence of a record and in the face of the stipulation, we submit, should reach no different decision than the Circuit Court reached, *i. e.*, affirm the District Court's decision. However, debtor submits that the findings of fact made by the District Court as to consideration do support the conclusion of the District Court granting stockholders' participation.

Answer to Government's Statement as to Interest of the United States.

1. The Interest of the United States in Terms of Legal Issues.

Under various statutes, including those referred to in the Government's brief, Congress has delegated a certain fact finding task to the District Courts, subject to review on appeal. So before a District Court can approve a plan of reorganization as fair, equitable and feasible, it must consider the evidence fully and thoroughly and make findings of fact based upon the evidence from which the conclusion may be drawn that the plan is fair, equitable and feasible and not discriminatory in favor of any class of creditors or stockholders. As the number of considered cases increases, there will come into existence a body of law which will constitute a guide to the District Courts to the extent that the decided cases are applicable

to the new cases which are coming up. The Government in its brief urges the Supreme Court to legislate a set of rules at this time which will be a guide to the District Courts and other governmental agencies in their fact finding tasks. To ask this Court to look into the future and set up rules to be applied to all of the different types of cases which may arise in corporate reorganizations is, of course, to ask the impracticable if not the impossible. It is the view of the respondent in this case that the Supreme Court should decide the issues presented before it in this case at this time in accordance with the record presented and that the best interest of the United States will be served if such procedure is followed by this Court. When the next case is presented then, this Court, we submit, should decide that case in the same way. To grant the Government's demands, we submit, would plunge this Supreme Court into the legislative field reserved to Congress.

2. The Interest of the United States in Terms of the General Public Interest.

The Government's counsel states quite frankly that the instant case is not intrinsically of major importance and that the amount involved is not large. The instant case, we submit, is of major importance to the parties involved in the reorganization and affected thereby, to-wit, the bondholders and the stockholders, and prompt and speedy reorganization will be to the best interests of all concerned.

The Government urges that the former bondholders having a first lien are displaced under the Plan and made stockholders "so that a new bond issue may be given precedence to their claim." It should be impressed upon the Court at this point again that any new bond issue that is

imposed upon the property of the debtor as reorganized will have to be voted by the old bondholders who will hold 77% plus of the voting stock of the reorganized company.

Under this heading in the Government's brief there appears what is probably not intentional upon the part of the Government's counsel, but it is clearly a wrong conclusion from a rather clear portion of the record. Government's counsel says: "On the other hand, the stockholders who have no equity in the assets, are allowed 23% of the assets and voting power which, in all probability, will enable them to exercise control of the corporation. [R. 96.]" What the Special Master said, as shown at this page of the record is as follows:

> "While the evidence in favor of permitting the old Class A stockholders, in view of the insolvency of the Debtor, to share on a stock basis with the bondholders, but in a minority and deferred position, might be stronger, the Special Master, after weighing carefully all of the factors involved, has concluded to recommend the approval of the modified plan by the judge. During the course of the hearings before the Special Master it was plainly indicated by objecting bondholders, Thomas K. Case and Adele M. Cowan, that a simple solution of the debtor's problem would be the payment in full of their bonds and all other non-assenting bonds. While a court of equity will not allow minority bondholders to be disregarded or unfairly treated in a reorganization plan, yet, on the other hand, it will not lend its aid to schemes by minority bondholders opposing a fair reorganization plan solely as a means of obtaining greater value or more favorable terms for his bonds than are to be given by the plan to the great

majority of bondholders. The cases on this subject are more or less rigid in their requirement that where insolvency exists the creditors must be fully compensated before old stockholders can be let into the picture at all. However, there are other ways of furnishing adequate compensation than by cash alone. The modified plan provides not only for placing the bondholders in a preferred position as to dividends and upon liquidation, but also for the reservation of a certain amount of Class A preferred stock to be held in the treasury for future use in the raising of money. The present bondholders, as new Class A stockholders, need have no concern over this reservation because their majority control of all of the stock will enable them to control the Board of Directors to the end that the use of this treasury Class A stock will be for wise and useful purposes for the benefit of all concerned. Nor need the bondholders, as the new Class A shareholders, be concerned over the possible creation of new liens against the assets in the new corporation, because such old bondholders, through such majority control, will have full say as to why, how, and when any such liens shall be created. It is true that the old Class A shareholders, the new Class B stockholders, by reason of their being in close touch with the business in the past and their present control of the corporation, may be able to organize more quickly and more concretely in controlling the policies of the new corporation than the old bondholders, the new Class A shareholders, since the latter are widely scattered and out of touch with the business. But this is a chance that the bondholders must take if the company is to be reorganized and put on its feet and not be subject to foreclosure or liquidation." [R. pp. 95-96.]

It is obvious that it is the conclusion of Government's counsel which appears in the Government's brief rather than the conclusion of the Special Master, which is fully quoted from the record above.

The statement is also made by Government's counsel that the Supreme Court has declared again and again that the condition of participation by junior interests in a reorganization plan is the prior satisfaction of all senior claims. No cases, however, are cited to support this broad statement. It is the contention of the respondent that the analysis of the decisions applicable to this case which are presented in respondent's brief and in the able decision of the District Court do not support any such conclusion.

Counsel for the Government has also failed to cite in his brief any authorities to support the proposition that junior interests for whom no equity remains, in order to participate, must contribute "necessary money or money's worth to the reorganized company." It is the position of the respondent, outlined in its briefs with authorities in support thereof, that any participation depends upon the contribution of a valuable, new and additional consideration to the reorganized company. [Respondent's Principal Brief, pp. 16 and 17; Resp. Supp. Brief, p. 2; R. pp. 225, 228.] Forbearance to exercise a right may be just as valuable a consideration as a contribution in money. The stockholders had a right to prevent foreclosure or reorganization and remain in control until 1944 (a period of eight years at the time the Plan was promulgated). That the forebearance or waiver of this right was equal in value to the participation afforded under the Plan to old Class A stockholders was found to be a fact by the Special Master, by the Trial Judge and by 90-plus per cent of the bondholders. This is not a case of giving

stockholders participation to avoid foreclosure and other litigation. Rather it was a participation granted for forebearing a right to control until 1944 which neither litigation nor foreclosure could disturb.

Counsel for the Government states that in the case under consideration the Court can see "devices by which stockholders faced with the consequences of the risk taking position which they have voluntarily assumed, have sought to conjure up considerations and to bargain, sometimes successfully, with valueless rights against the real money and real property of the bondholders. We have, in short, relatively simple examples of typical methods by which, too often with judicial aid and comfort, stockholder interests have frequently succeeded in whittling down the principles intended by this Court for the protection of creditors." These are high sounding phrases and may apply in some reorganizations but they do not fit the instant case. At the outset, the Debtor Corporation in 1936 was managed by a board of directors voted into office by the old Class A shareholders. [R. pp. 100-101.] They were in control of the debtor and its assets and the trust indenture securing the income bonds held by the bondholders could not be in default and foreclosed until 1944. [R. pp. 76, 320-321.] Profitable shipbuilding business of any magnitude, with attendant profits, could not be undertaken with the top-heavy lien of the bond structure because surety company completion bonds could not be obtained. [R. p. 322.] The stockholders did not have to "conjure up considerations and to bargain * * * with valueless rights against * * * the bondholders." There existed, by reason of the 1930 reorganization, the right to management and control with no fear of foreclosure until 1944. [R. p. 320.] For the Government to

say that the stockholders had to conjure up this right or that it was valueless is to beg the question.

After months of study and consideration, the board of directors of Respondent prepared and Respondent presented the Plan of Reorganization to the Division of Corporations of the State of California on February 13, 1937 [R. p. 145] and after a public hearing, of which notice to all creditors and stockholders of respondent was given, the Division of Corporations of the State of California issued a permit dated June 14, 1937 [R. pp. 42-44] to Respondent wherein the terms and conditions of the proposed issuance of certificates of deposit was held to be fair and the respondent was permitted to solicit consents to the Plan from its stockholders and bondholders. This Plan contemplated two methods of consummation: either (1) by consent of the parties, or (2) a Section 77B proceeding, and that the method to be followed would be determined by the board of directors of respondent.

Prior to the filing on January 28, 1938, [R. p. 309] of the voluntary petition under Section 77B by respondent, the Plan was properly accepted by the holders of over 90% in amount of the outstanding bonds; over 99% in amount of the outstanding Class A stock, and over 89% in amount of Class B stock. [R. pp. 207, 313.] Respondent's board of directors, in the exercise of its discretion, determined that this percentage of bonds was not near enough 100% to warrant consummation of the Plan without a 77B proceeding. [R. pp. 80, 313.] A voluntary petition under the provisions of Section 77B was then filed. But at that time respondent, by voluntary agreement with its affected security holders, *i. e.*, its shareholders and bondholders, had a Plan which was consented

to by more than the requisite percentages required by Section 77B.

The Plan proposed in respondent's original petition [R. p. 88] contemplated a stock division of 71% to bondholders and 29% to old Class A stockholders. As a result of the negotiations between bondholders' representatives and respondent during the hearings before the Special Master, a modified Plan was formulated and presented by respondent changing the percentages to approximately 77% to bondholders and approximately 23% to Class A stockholders, respectively, and with the other differentiating features described elsewhere in the briefs and in the record. [R. pp. 207-210.]

Counsel for the Government emphasizes the necessity of eliminating top-heavy debt structures in corporate reorganizations, so as to avoid future reorganizations. That was one of the ends sought to be accomplished in the present reorganization by having a simple stock structure of preferred and common stock which was not top-heavy and wherein the dollar par value of the outstanding shares equaled the appraisal value of the fixed and current assets at the time of the reorganization. [R. pp. 80, 206-207.]

Much is said in the Government's brief as to the theory of dealing with priorities in corporate reorganizations. From a practical point of view in many reorganizations, certain of the theoretical views and rules are not applicable. There are usually no clear cut lines of demarcation. A typical illustration would be an insolvent corporation with a first mortgage bond issue covering all of its assets which are mortgageable by law, a number of unsecured creditors, and some stockholders. At the time of the preparation of a reorganization plan, if there were

cash in bank and other current assets, the question of law would have to be determined as to what were mortgageable assets. The cases are quite clear that cash in bank and accounts receivable, until reduced to the possession of the bond issue trustee, are not subject to the lien of the trust indenture. If there were mortgaged and unmortgaged assets and if the value of all of the mortgaged assets at the time of the reorganization was less than the total claim under the bond issue trust indenture, it would then be necessary to arrive at a fair valuation of the property which was subject to the mortgage and allocate said amount exclusively to the bonds. The second step would then be in order, *i. e.*, a fair proration of the unmortgaged assets between the deficiency of the bond claim and the amount of the claim of the unsecured creditors. No one will question that a fair treatment is accorded to the bondholders and the unsecured creditors provided all assets were evaluated fairly and the bondholders were given all the assets, legally mortgaged, and provided further that the proration of the unmortgaged assets between the deficiency claim under the trust indenture and the claim of the unsecured creditors is a fair and equitable proration. It must be borne in mind that when you come to the second step that each of the claims applies equally to all of the unmortgaged assets. In such a case, the junior issue (unsecured creditors) would participate before a senior issue was provided for in full.

Let us now briefly see how the instant case may be compared with the foregoing hypothetical case. The mortgaged assets, including those which can be reached by deficiency action through the pledge of the shares of the subsidiary company under the trust indenture, to-wit: the current assets, including cash in bank, are very much

less than the total claim of the bondholders under the trust indenture. [R. p. 206.] There are no unsecured creditors affected by the Plan. [R. p. 326.] The old stockholders and the bondholders have rights which at the same time extend and apply to the whole of the assets of respondent. The stockholders' right to control until 1944 applies to all of the assets, as does the lien of the bond indenture. The first step on the hypothetical case could be omitted in the instant case. It was therefore necessary in arriving at a fair plan as between the stockholders and the bondholders to prorate, fairly and equitably by value, the interest of the shareholders in the entire assets of respondent and the interest of the bondholders in said assets since the rights of each group applied to the whole thereof.

As pointed out above, this was done voluntarily by respondent, its stockholders and bondholders prior to the filing of the petition under Section 77B. During the hearings before the Special Master and the Court in the 77B proceeding, as heretofore stated, this proration was varied to a point where the Special Master recommended and the Court determined that a fair bargain (to use the language of the Government's counsel in his brief) had been reached. This determination by the Court was based upon the evidence introduced and full and complete findings of fact were made by the Special Master and the District Judge, heretofore referred to and quoted in part in this brief and set forth in the record.

We submit that this proration in the instant case is a fair and equitable application of the priority theory as recognized by the decisions of this Court and discussed at length in the Government's brief.

Another point made by counsel for the Government in discussing the general public interest is that in the use of reorganization machinery, managements perpetuate their management prerogatives. This was not the purpose, intent or result of the instant reorganization. As clearly pointed out in the Plan [R. p. 36], the management and the voting control of respondent under the Plan is to be surrendered to the bondholders. The Plan safeguards this feature [R. p. 61] by the fixing of a date for the meeting of the stockholders of the new corporation within ninety days after its incorporation, or within such further extension of time as may be provided by order of the Court, and in connection with such election the new corporation is not to take any part in the election of the new board of directors except to send out the formal notice and the usual form of proxy, without designation of a proxy holder, and any and all persons desiring to solicit votes or proxies will have to do so entirely at such person's own expense. We repeat that in the instant case there is no attempt to continue control by the present management of respondent and we submit that the bondholders approved the Plan prior to the filing of the 77B proceeding on the basis and for the consideration that they, the bondholders, were obtaining from the stockholders by means of the Plan the immediate opportunity to control respondent and

its assets which otherwise, but for the Plan, the bondholders would not have been able to obtain until 1944. This Plan was to be carried out either outside or inside 77B proceedings.

The avoidance of expensive litigation is urged by the government as not being a proper consideration for permitting the participation of stockholders and other junior interests in a plan of reorganization. In general we agree with the government on this point and submit that this element—the avoidance of expensive litigation—was not the primary factor, but only a minor factor which motivated the trial court in making its findings.

In answering the government's point as to the interest of the United States in terms of general public interest in this case, we have touched upon various phases of the position of respondent in general, for this was the approach of counsel for the government in presenting the point. We would again respectfully submit that the greatest general public interest can best be served by a disposition by the Supreme Court, case by case, of questions presented to it, and not by acting upon the request of the government made in its brief that this Court lay down in this case a set of general rules or a yardstick to guide the United States District Courts and other governmental agencies in their fact finding tasks which have been delegated to such courts and agencies by Congress.

We therefore urge this Court to decide this case on the record as submitted, and we are confident that this course will be followed by the court.

I.

Answer to Government's Point I.

The Government erroneously contends that "No PLAN OF REORGANIZATION WHICH FAILS TO GIVE PRECEDENCE TO THE ENTIRE CLAIM OF SENIOR CREDITORS BEFORE PARTICIPATION OF JUNIOR CREDITORS OR STOCKHOLDERS IS FAIR AND EQUITABLE AS A MATTER OF LAW."

We have already pointed out that when both junior and senior creditors have an interest in the same assets, an evaluation of these interests may clearly require that junior creditors participate before the entire claim of senior creditors is given precedence. Debtor has no quarrel with the holding of this Court in the case of *Northern Pacific Railway Co. v. Boyd,* 228 U. S. 482 (1912), and related cases referred to by government's counsel, provided the holdings in the cases are properly stated and properly applied. This Court in the *Boyd* case refused to sustain a reorganization where a part of the mortgaged assets was taken from the bondholders and allocated to the stockholders to the detriment of an unsecured general creditor whose position was junior to that of the bondholders and senior to that of the stockholders. We submit that this is all that the *Boyd* case held and all that we have said earlier in this brief with respect to the priority rule and the fairness of the plan in this case in dealing with the old Class A shareholders and bondholders of respondent is applicable at this point.

The principle of the *Boyd* case is not abrogated by Section 77B of the Bankruptcy Act or the Chandler Bill, and, while there have been numerous decisions of the

District Courts and Courts of Appeal involving Section 77B since its adoption, many of which have been reviewed and cited in the briefs on file in this case, we submit that in the main the courts have undertaken to carry out the legislative intent of Congress as expressed in these acts. The able decision of the District Court in this case, we submit, clearly sets forth the possibilities and difficulties of corporate reorganizations under the law as it existed prior to the enactment of Section 77B and the purpose and end sought to be attained by the enactment of that section by Congress. We also submit that the District Judge made a correct application of the law to the facts of the instant case. In the District Court's careful consideration of the plan and the problems of respondent and its security holders [R. pp. 202-245] weight is given to the evidence in the case as to the expression of the wishes on a democratic basis of the bondholders and the stockholders. We submit, however, that no undue weight is given to the fact that substantially all of the bondholders had consented to the plan prior to the 77B proceeding in which the District Court confirmed the plan as modified. The District Court said in its opinion [R. p. 229] that, "There does not seem to be any difference of opinion among those bondholders who believe the stockholders should have participation," and that "The only two objectors apparently are the dissenting bondholders—holding $18,500.00 face value of the bonds—who want to be paid off in full, and who are opposed to bondholders who deposited under the 1930 reorganization and stockholders getting anything until they

are so paid." The objectors referred to are the petitioners before this Court. [R. pp. 242-243.]

The District Court, in facing the problem of the participation of the old stockholders, specifically stated the question in its opinion [R. p. 230] as follows:

> "This Court's problem, therefore, is simply this: May the old stockholders be allowed anything?"

And in answering the question stated the Court said [R. p. 233]:

> "Under the modified plan, since the bondholders are given a very substantial majority of the new stock, they at all times will control the new corporation by having the legal capacity to elect a majority of the Board, and may even liquidate the corporation. Actually the bondholders are being given practically everything they could get after they had gone through the trouble, expense and delay incident to foreclosure —even if a foreclosure could be had in spite of the moratorium agreement. The exception is this: they are possibly foregoing a 23/100ths interest in the business in consideration of an immediate reorganization. We say 'possibly' because of the preference given to preferred stockholders upon liquidation, which may give them *all* the assets instead of 77/100ths thereof. Bondholders apparently believe that a bird in the hand is worth two in the bush; that a seventy-seven percent. preferential interest in the profits of a growing business may pull them out entirely, and that an immediate forced liquidation might bring them very little return."

II.

Answer to Government's Point II.

Counsel for debtor do not take issue with the Government on the general proposition in its Point II that "A PLAN WHICH IS UNFAIR AS A MATTER OF LAW CANNOT BE MADE VALID BY THE CONSENT OF REQUIRED PERCENTAGE OF A CLASS OF SECURITY HOLDERS." We do, however, wish to respectfully call the attention of this Court to the fact that counsel for the Government has argued this point in great detail, with exhaustive citation of authorities, but we submit that the point discussed and authorities cited have no bearing whatever on the instant case.

III.

Answer to Government's Point III.

The Government contents that "THE ALLEGED 'CONSIDERATION' TO BE FURNISHED BY THE STOCKHOLDERS DOES NOT SUPPORT THEIR PARTICIPATION UNDER THE PLAN."

We will not lengthen this brief at this point by repeating the argument set forth briefly in that portion of this brief answering the Government's proposition that the public interest is involved.

Government's counsel refers to the *Kansas City Terminal* cases (271 U. S. 445, 455-456) and calls attention to that portion of the Court's decision in which it is stated that "circumstances may justify an offer of different amounts of the same grade of securities to both creditors and stockholders." In the instant case different amounts of the same class of capital stock [R. p. 12] were offered to and a plan was accepted by substantially all of the bondholders and the stockholders of respondent prior to the filing of the voluntary petition in

77B. The bondholders agreed to accept approximately 71% of the shares of common stock and the stockholders agreed to accept 29% of the same grade of stock. This was the original plan which was covered by the permit of the Division of Corporations of the State of California after a public hearing of which all bondholders and stockholders were notified and at which they had an opportunity to be present and to be heard, and based upon which hearing the Division of Corporations issued its permit granting authority to the debtor to solicit consents thereto. During this proceeding [R. p. 88] the basis was changed to 77% to the bondholders and 23% to the old Class A stockholders, and the bondholders were to receive preferred and the old stockholders common stock, respectively.

Counsel for the Government again at this point in their brief refer to the old Class A shareholders as "representatives of valueless interests" and also state that "the attempt now is to justify participation for these interests not upon the basis of a cash consideration or even its equivalent but upon the basis of a 'consideration' which, at best, is technical, and at times wholly specious. The present case is but one instance in which such efforts have thus far met with success." This type of argument on the part of Government's counsel, as heretofore pointed out in this brief, merely begs the question. Counsel for the Government has attempted to state the substance of the findings of fact of the District Court as to the basis for the participation by A shareholders. The findings of fact of the District Court are clearly set forth in the record which speaks for itself.

It is the position of debtor that the petitioners before this Court bound themselves by a written stipulation not

to attack the findings of the District Judge, and the petitioners have repeatedly reiterated in their brief that they have lived up to that stipulation. Counsel for debtor submit that at no point in the petitioner's specifications of error or in their brief have they questioned the findings of fact of the trial court as to the value or adequacy of the consideration furnished by the stockholders to support their participation under the plan. The position of the petitioners has at all times been that "the Court erred in concluding under the circumstances disclosed in this case, that present stockholders of an insolvent corporation, in which they had no equity, could participate in the Plan of Reorganization, either to the extent of 23% or any other percentage." (Petitioner's Br. p. 27.) The insolvency of respondent is the ground of attack by petitioners and not the inadequacy flowing from the stockholders.

As pointed out elsewhere in this brief, the Government should not be permitted to urge points on this appeal which cannot be and are not raised or urged by the petitioners.

The Government urges that the findings of the District Court as to the value to the new company to retain the present Class A stockholders and their interest in the business was apparently regarded as sufficient by the District Court to support the conclusion that the plan was fair and equitable and permit the stockholders to have a stock interest. There is nothing in the record that would warrant the expression of this opinion on the part of Government's counsel. It is the contention of respondent that this element in the consideration was of minor importance with the District Court and with the

Special Master, as is clearly indicated by the report of the Special Master and the opinion of the Court. It was certainly not a vital element in the Plan of Reorganization or appropriate provisions would have been included with respect to a management contract or voting trust control to insure continuity of management. The respondent and all interested parties were content to permit the matter to rest upon a hope that the old Class A shareholders, having been allocated a participation in the reorganized company, would continue their interest. The management expressed such a willingness. [R. p. 227.] The "principal valuable consideration" [R. p. 321] passing between the bondholders and the stockholders to justify participation of the stockholders in the plan is the virtual abrogation of said agreement deferring foreclosure until 1944.

Counsel for the Government argues that there was no such right once the petition for reorganization was voluntarily filed by the stockholders who controlled the respondent. The weakness of this argument is that the Plan of Reorganization was agreed to by substantially all of the stockholders and substantially all of the bondholders and became a contract right between them and respondent before the voluntary petition was filed. As a part of this plan it was optional with the board of directors of the respondent to determine whether to consummate the plan by a voluntary reorganization, if sufficient consents could be obtained, or to complete it by a 77B proceeding. This contractual right in the stockholders, created under the Plan of Reorganization thus agreed to before the adoption of the 77B proceeding, exists today and the plan was binding on the stockholders and the bondholders consenting thereto before the filing of the

voluntary petition, it was binding after the filing of the voluntary petition, and would be binding if the petition were dismissed. If the position of the debtor is sound, that surrender of the right of control for an eight-year period was adequate consideration for a minority and junior participation by the old Class "A" stockholders, such right of participation was secured by contract before, and as a condition precedent to, the institution of the 77B proceedings. Surely nothing would be more unfair or inequitable than a holding that the surrender of a consideration on condition ceases to be a consideration for such condition because it was surrendered. Over 90% of the bondholders would be estopped to make any such claim as they were parties to the contract under which the consideration was surrendered to them. This is not a case of stockholders making a contract for participation in advance of 77B for a wholly inadequate and unfair consideration. Rather, it is one where the contract was for an adequate consideration, to-wit: surrender of eight years' control, and Government counsel contends that this consideration lost its efficacy when surrendered in accordance with the contract.

The argument advanced by counsel for the Government that after approval of the petition, debtor was powerless to withdraw and dismiss the petition, even though the requirements of a fair plan precluded the participation of the Class A shareholders, is not sound because it is submitted that the consenting bondholders and the consenting shareholders to the voluntary proceeding instituted

prior to the filing of the 77B proceeding were bound by their contract and that a court of equity would not abrogate such a contract made in good faith, but on the contrary would enforce a specific performance thereof.

The Government's argument that there was no fresh contribution in money or money's worth and that no contribution can be found in the surrender of a right already waived, is without merit. As pointed out above, the contract or Plan of Reorganization was entered into between the parties before the institution of the reorganization proceedings in Court. The consideration flowing from the stockholders passed, or an agreement with respect to its passage was entered into, and in the same agreement the participating interests of the stockholders and bondholders who were parties thereto in the assets of the debtor were fixed. The parties contemplated the possibility of a 77B proceeding and that the plan might be carried out in that way if it was deemed necessary by the board of directors of respondent and for the best interests of the company and its security holders. [R. p. 35.] It is submitted that a step provided for therein by the parties as a means to carry out the contract cannot, when said step is taken, be urged as a ground for avoiding the contract or making worthless the consideration which was the basis thereof.

The Government argues that the District Court could not properly place any value on the abrogation of the right to postponement of foreclosure until 1944 because the Government argues that that right was surrendered upon

the filing of the 77B petition. We submit that the District Court's conclusion was sound that a dismissal was the only fair and equitable alternative if the Plan was not confirmed in view of the fact that the reorganization plan was entered into by Respondent and substantially all of its bondholders and stockholders before the voluntary proceeding under Section 77B was instituted.

We submit that the opinion of the District Court clearly discloses the weight which it gave to the saving of expense and the avoidance of lengthy litigation. It is the position of the debtor that the attitude of the stockholders in this matter was not that of a "dog in the manger," or an obstructionist. The stockholders in control of the board of directors of debtor in 1936 and 1937 were the moving parties to develop and propose this constructive plan of reorganization for the best interests of all of the security holders of debtor.

As to the element involved in maintaining the debtor as a going concern, this was a saving to the enterprise brought about by the willingness of the stockholders to cooperate and abrogate the 1930 agreement. The saving of the maintenance expense on the northern properties for eight years, amounting to $172,000.00, would not have been possible were it not for the plan and the consent on the part of the stockholders thereto. It is submitted that this is a consideration for which the stockholders were entitled to compensation. No involuntary proceeding under Section 77B could have been instituted on the motion of the

bondholders. There was no default and nothing was due to the bondholders. There were no other general creditors of the debtor. A 77B proceeding which would eliminate the necessity of foreclosure and maintain the continuity of the debtor as a going concern was only possible through the cooperation and voluntary action of the Class A shareholders who were in voting control of the debtor at the time of the promulgation of the plan in 1937 and also at the time of the filing of the voluntary petition under Section 77B in January of 1938. Therefore, the only possible immediate relief to bondholders and stockholders of debtor (short of 1944) was dependent upon the voluntary cooperation of the Class A shareholders of debtor which was given heartily, based, however, upon the plan of reorganization [R. pp. 25-41], consents to which were solicited under the permit of the Division of Corporations of the State of California [R. pp. 42-44] and which was consented to by the holders of substantially all of the outstanding bonds and stockholders, voluntarily, pursuant to solicitation by respondents, prior to the filing of the 77B proceeding in January of 1938.

It is submitted by counsel for respondent that the consideration flowing from the shareholders to the bondholders is adequate and completely compensates the bondholders for that portion of the assets which are allocated to the old stockholders under the plan; that such was the finding of fact by the trial court; that petitioners before this Court have not attacked that finding and were bound by stipulation not to do so; that the Government cannot

raise any point in this appeal not raised by the petitioners; that a full record upon which such finding is made is not before this Court, but that if this Court desires to analyze the conclusions reached by the trial court on this point based upon the limited record before it, this Court should reach the same conclusion as was reached by the District Court and the Circuit Court of Appeals that the consideration flowing from the old stockholders to the bondholders was adequate to support the participation of the old stockholders under the plan.

Respectfully submitted,

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